Entrepreneurs: When should you scale your team?

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The option to redeploy talent can give a greater taste for risk — and reap rewards.

As an entrepreneur building a company, should you hire in line with market demand or anticipate it? The choice you make, along with which profiles you hire, can shape your

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success. Received wisdom has it that entrepreneurs start lean and grow cautiously, unwilling to overcommit tight resources. But this is only one side of the story.

New research by IESE's Liinus Hietaniemi, with co-authors Simone Santamaria, Aleksandra Kacperczyk and Juhana Peltonen, shows how and why different entrepreneurs pursue different team scaling strategies. One important factor is whether they are standalone entrepreneurs or operate multiple startups.

Operating multiple startups creates an option to transfer staff elsewhere if one venture fails to grow. This option reduces the sunk cost of overcommitment, allowing the "portfolio entrepreneurs" to hire more aggressively early on. Hiring aggressively will allow these entrepreneurs to develop capabilities faster, which can have an outsized impact on firm success.

Flexibility for the win

Using a decade's worth of employee-employer matched data for all Finnish startups, the researchers found that a key factor in determining the best time to hire was the entrepreneur's profile.

Some entrepreneurs are focused on a single, standalone company. If they overhire too quickly, that's more people who may potentially need to be laid off later — and depending on local firing laws, this can be a significant motive for caution.

Meanwhile, portfolio entrepreneurs — those with more than one startup to their name — can afford to scale more quickly, because if one venture fails, they may be able to redeploy employees into their other businesses. Such entrepreneurs were much more likely to hire people upfront, particularly employees with easily transferable skills. Those who didn't have the option to redeploy talent were more likely to run a lean startup.

"The option to redeploy employees reduces the sunk costs of hiring," says Hietaniemi. "Without the redeployment option, if your product is unsuccessful, you'll have to lay off the team. And, depending on the rigidity of the local labor market, letting them go may be costly."

In addition to the redeployment option, the researchers found that the relatedness of the ventures under the same portfolio and the transferability of the hired employees increased redeployability and thereby affected the decision to scale the team earlier.

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Early bird gets the worm

“This takes place in the early stages of a startup, when there is uncertainty about the market demand for the product,” Hietaniemi says. “Portfolio entrepreneurs will look for profiles that allow them the flexibility to move and redeploy staff, depending on where there is growth.”

Redeployment of staff is less relevant for standalone entrepreneurs, who are less likely to specifically target profiles with transferable skills and more cautious about bringing in new staff — unless they receive positive market signals that increase the likelihood of success.

The flexibility inherent in the strategy of portfolio entrepreneurs, with fast scaling, transferable skills and the ability to develop unique capabilities from the outset, may give them an advantage that leads to greater success in the long run.

Leveling the playing field

When labor markets are less rigid, investments in human capital become less risky for standalone entrepreneurs.

“In Finland, which is the context of our study, the labor laws are quite rigid. If someone has worked for you for more than six months, it will cost you at least one month, and often more, to lay off an employee. For a struggling startup, that’s a lot of money,” Hietaniemi states.

Adhering to proper termination procedures, such as giving notice or providing reasonable cause and severance pay, may take a considerable amount of time and can also lead to legal complications, including wrongful termination lawsuits.

Less rigid labor laws could, therefore, play a role in leveling the playing field for all entrepreneurs. On the other hand, benefits to entrepreneurs will often weaken the position of employees, so any reforms would need to be balanced.

Methodology

The researchers used data on employment contracts and the annual accounts of all active limited liability firms in Finland, including all ventures of standalone and portfolio founders launched between 2007 and 2017.

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